CRA Insights

CRA Charles River Associates

September 2020

COVID-19 crisis – Mortgage forbearance considerations

Key takeaways

During the current COVID-19 crisis, many financial institutions have responded to the less favorable and more uncertain economic outlook, and to the CARES Act, by tightening their lending standards while increasing allowable forbearance activity. Financial institutions should be aware of potential increased fair lending risks resulting from these changes. Fair lending risks could be elevated because: (i) the predictive performance of pre-COVID credit models might be reduced during and after this period; (ii) different demographic groups have been affected differently by this crisis; (iii) the demand for hardship relief increased rapidly and unexpectedly; and (iv) the responses to the crisis required relatively fast implementation.

During this period of ongoing uncertainty and economic volatility, enhanced fair-lending monitoring is prudent. Any time a financial institution implements new policies or updates existing policies, any potential unintended differential outcomes across protected classes must be considered.

Background

The COVID-19 pandemic has had significant negative economic impacts on consumers and businesses. The economic activity as measured by the real gross domestic product decreased at an annual rate of 5% in the first quarter (Q1) of 2020 and at an annual rate of 31.7% in the second quarter (Q2) of 2020.[1] From March 15, 2020 through September 5, 2020, 60.2 million Americans filed initial unemployment claims.[2] The second quarter of 2020 brought the largest quarterly increase in delinquencies since the Mortgage Bankers Association started its National Delinquency Survey in 1979. While, the current mortgage delinquency rates have not reached those observed during the Great Recession (see Figure 1), it is likely that without regulatory intervention and the COVID-19-related forbearance options offered by financial institutions, the current rates would have been larger.[3] The severity of the increased delinquency rates has varied by loan type. As illustrated in Figure 2, for all mortgages past due, regardless of loan type, the delinquency rate of

[1] Bureau of Economic Analysis, Gross Domestic Product, 2nd Quarter 2020 (Second Estimate), news release, August 27, 2020, available at https://www.bea.gov/index.php/news/2020/gross-domestic-product-2nd-quarter-2020-second-estimate-corporate-profits-2nd-quarter, last accessed September 10, 2020.

[2] U.S. Employment and Training Administration, Initial Claims, Seasonally Adjusted, retrieved from FRED, Federal Reserve Bank of St. Louis, https://fred.stlouisfed.org/series/ICSA, last accessed September 14, 2020.

[3] None of the data series referenced here are seasonally adjusted.

mortgage loans in the second quarter of 2020 almost reached the rate observed at the peak of the Great Recession.

The Coronavirus Aid, Relief, and Economic Security (CARES) Act, signed into law on March 27, 2020, provided forbearance options to borrowers experiencing financial hardship who have federally backed mortgages.[4] The CARES Act also placed a 60-day moratorium on foreclosures from March 18, 2020 for federally backed mortgages, which was extended until the end of August, 2020.[5] For mortgages backed by Fannie Mae and Freddie Mac, this moratorium was extended to at least the end of 2020.[6]

Further, the CARES Act restricted the reporting of delinquencies to credit bureaus during and up to 120 days after the COVID-19 national emergency is declared over. A financial institution has to report as current to the credit bureaus a debt obligation of a borrower whose account was not delinquent prior to the accommodation, and for which the borrower received an accommodation after January 31, 2020.[7]

Many states have also implemented temporary measures to protect consumers affected by the COVID-19 pandemic. For example, New York passed a law requiring state financial institutions not covered by the CARES Act to grant forbearance and post-forbearance relief until the cessation of all COVID-19-based, state-imposed limits on commercial activities in the state.[8] California recently passed legislation requiring mortgage services to provide notification of forbearance denial reasons through April 1, 2021 for non-federally backed mortgage loans. A servicer must provide a written explanation of why it denied a forbearance request to a borrower who (i) was current as of February 1, 2020, and (ii) experienced a financial hardship related to the COVID-19 emergency that prevented timely payments on the mortgage obligation being made. The law also requires servicers to consider non-federally backed mortgage loans for post-forbearance options.[9]

---

[4] The provisions of the CARES Act are available here: https://www.congress.gov/bill/116th-congress/house-bill/748/, last accessed August 27, 2020, and https://www.congress.gov/116/plaws/publ136/PLAW-116publ136.pdf, last accessed August 27, 2020. Sections 4022 and 4023 relate to mortgage forbearance. Specifically, "(b) FORBEARANCE — (1) IN GENERAL.—During the covered period, a borrower with a Federally backed mortgage loan experiencing a financial hardship due, directly or indirectly, to the COVID–19 emergency may request forbearance on the Federally backed mortgage loan, regardless of delinquency status, by— (A) submitting a request to the borrower's servicer; and (B) affirming that the borrower is experiencing a financial hardship during the COVID–19 emergency. (2) DURATION OF FORBEARANCE.—Upon a request by a borrower for forbearance under paragraph (1), such forbearance shall be granted for up to 180 days, and shall be extended for an additional period of up to 180 days at the request of the borrower, provided that, at the borrower's request, either the initial or extended period of forbearance may be shortened. (3) ACCRUAL OF INTEREST OR FEES.—During a period of forbearance described in this subsection, no fees, penalties, or interest beyond the amounts scheduled or calculated as if the borrower made all contractual payments on time and in full under the terms of the mortgage contract, shall accrue on the borrower's account."

[5] Consumer Financial Protection Board, Learn about mortgage relief options and protections, at https://www.consumerfinance.gov/coronavirus/mortgage-and-housing-assistance/mortgage-relief/.

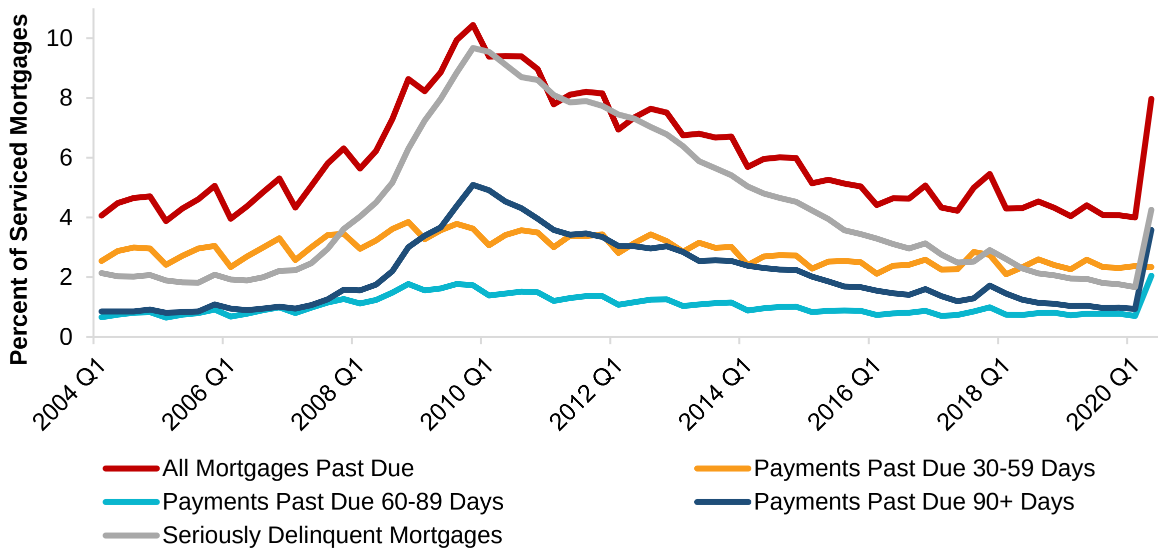
[6] Federal Housing Finance Agency, "FHFA Extends Foreclosure and REO Eviction Moratoriums," news release, August 27, 2020, at https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Extends-Foreclosure-and-REO-Eviction-Moratoriums.aspx.

[7] The Consumer Data Industry Association (CDIA) offered guidance for credit reporting in Metro 2 format, in response to the CARES Act and for the period following the end of the CARES Act. See https://www.cdiaonline.org/covid-19/, last accessed August 27, 2020.

[8] National Consumer Law Foundation, "Covid-19 State Foreclosure Moratoriums and Stays," July 8, 2020, https://www.nclc.org/issues/foreclosures-and-mortgages/covid-19-state-foreclosure-moratoriums-and-stays.html.

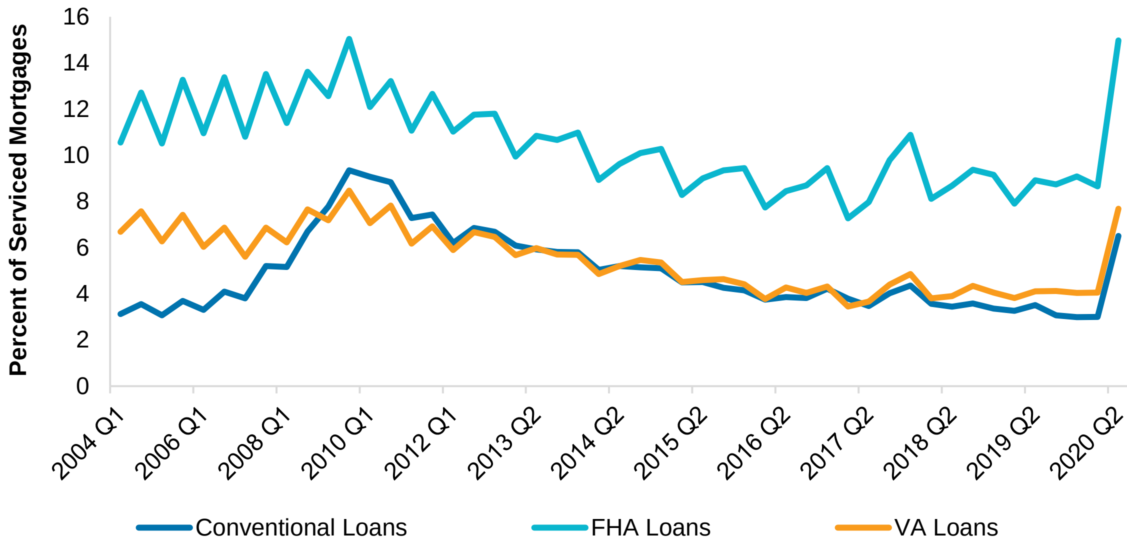
[9] Holly Spencer Bunting and Brian J. Stief**,** "California Enacts Two Bills with Significant Impacts on Mortgage Licensees in the State," Mayer Brown, *The Consumer Financial Services Review Blog*, September 4, 2020, available at https://www.cfsreview.com/2020/09/california-enacts-two-bills-with-significant-impacts-on-mortgage-licensees-in-the-state/, last accessed on September 14, 2020.

Figure 1: Mortgage delinquency rates, 2004 Q1 – 2020 Q2



Source: Mortgage Bankers Association, National Delinquency Survey

Figure 2: All mortgages past due, delinquency rates, by loan type, 2004 Q1 – 2020 Q2

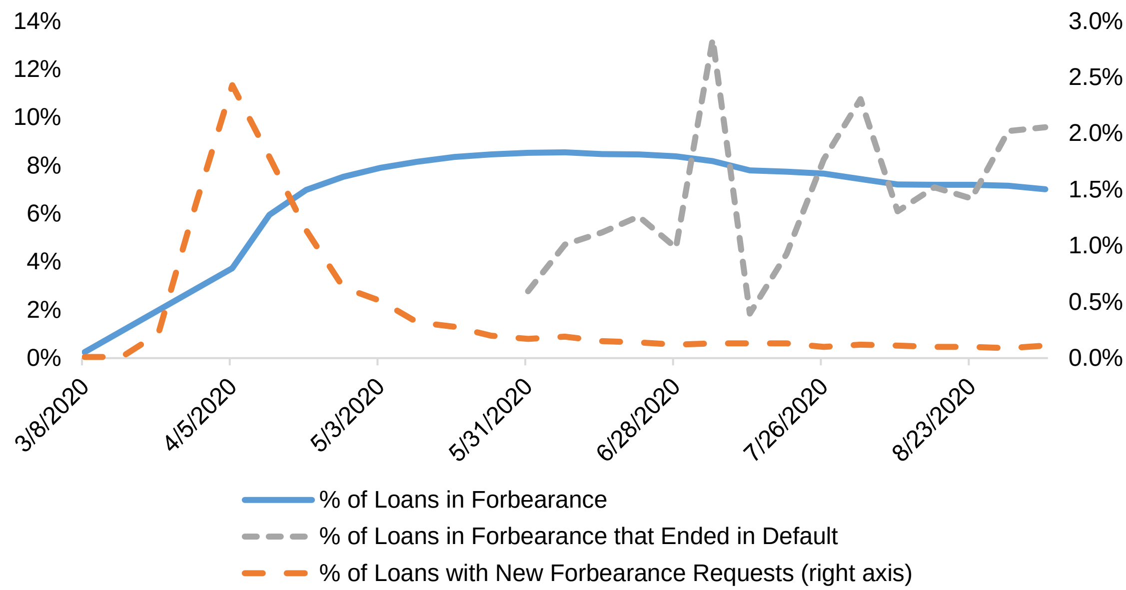


Source: Mortgage Bankers Association, National Delinquency Survey

Both requests for mortgage forbearance and the number of loans granted forbearance have increased significantly during the COVID-19 pandemic, as summarized in Figure 3. From the beginning of March 2020 to the beginning of September 2020, the percent of loans with new forbearance requests by borrowers increased 11-fold, from 0.01% to 0.11% (right axis), and the percent of loans in forbearance increased 28-fold from 0.25% to 7.0% (left axis). A relatively large fraction of loans in forbearance end in default.[10]

[10] Mortgage Bankers Association, Weekly Forbearance and Call Volume Survey.

Figure 3: Mortgage forbearance activity



Source: Mortgage Bankers Association, Weekly Forbearance and Call Volume Survey

As summarized in Figure 4, during 2020 Q2, domestic banks sharply tightened their lending standards.[11] Stricter lending standards became important during this period for financial institutions given the onset of a sharp downturn of uncertain duration. As illustrated in Table 1, during April and May 2020, for purchase money mortgages, the early COVID-19 period had not yet led to any significant changes in average FICO score, loan-to-value (LTV), or debt-to-income (DTI). The average loan-to-value was 88.2% and the average debt-to-income ratio was 37.4%.

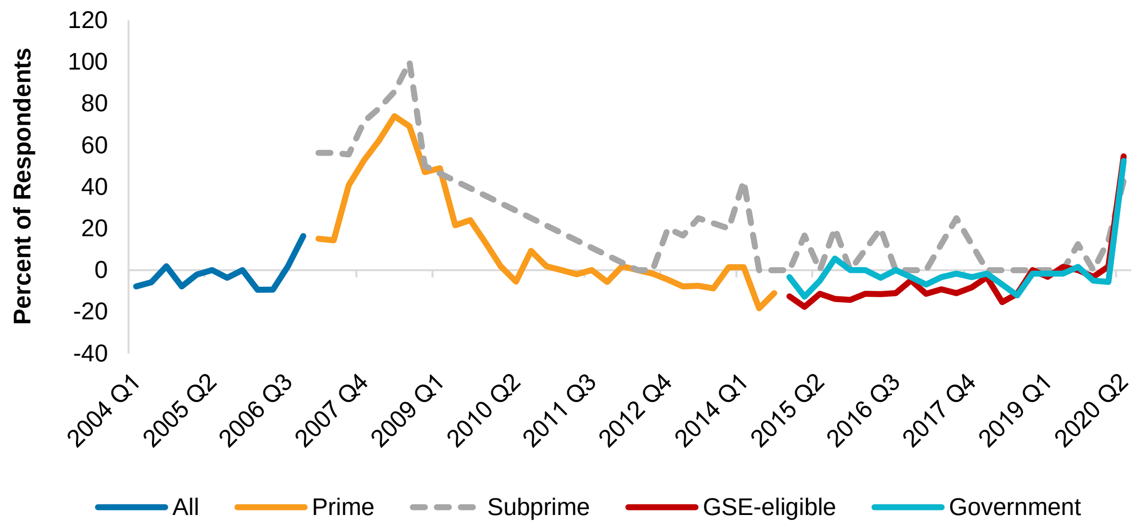
The data available to financial institutions to make credit decisions may be impacted by inconsistencies between how servicers report accounts in forbearance or deferrals to the credit bureaus.[12] The crisis may also directly impact the predictive performance of existing credit models. This is because these models were estimated using data reflecting non-crisis behavior, less uncertainty, and less severe economic outcomes. The CARES Act restrictions with respect to credit reporting may make it more difficult to differentiate based on the information in the credit reports between borrowers who do not make their payments because of the COVID-19 crisis forbearance request and those who do not make their payments as originally scheduled for other reasons.

---

[11] Board of Governors of The Federal Reserve System, "The July 2020 Senior Loan Officer Opinion Survey on Bank Lending Practices," available at https://www.federalreserve.gov/data/sloos/sloos-202007.htm, last accessed on August 25, 2020. Respondent banks received the survey on June 22, 2020, and responses were due by July 2, 2020.

[12] Brandon Ivey, "Are the Non-Agency COVID-19 Forbearance Numbers Reliable?" *Inside Mortgage Finance News*, July 24, 2020.

Figure 4: Net percentage of domestic respondents tightening standards for residential mortgage loans, 2004 Q1 – 2020 Q2



Source: The July 2020 Senior Loan Officer Opinion Survey on Bank Lending Practices

Table 1: Agency mortgages – Average values – FICO, DTI, LTV

	Purchase Money Mortgages			Refinance Mortgages		
Year	FICO	DTI	LTV	FICO	DTI	LTV
2013	732.8	35.2	86.7	743.8	32.0	74.9
2014	727.8	36.0	86.9	727.0	34.4	72.3
2015	725.1	36.3	87.6	732.0	33.9	71.6
2016	724.6	36.6	87.7	733.4	33.9	70.0
2017	724.8	37.4	87.9	728.1	35.7	69.4
2018	725.0	38.5	87.8	725.0	38.5	87.8
2019 Q4	726.8	37.9	88.0	741.9	35.1	70.5
2020 Q1	727.4	38.1	88.1	742.2	35.4	69.1
2020 Apr-May	729.2	37.4	88.2	753.2	33.4	68.6

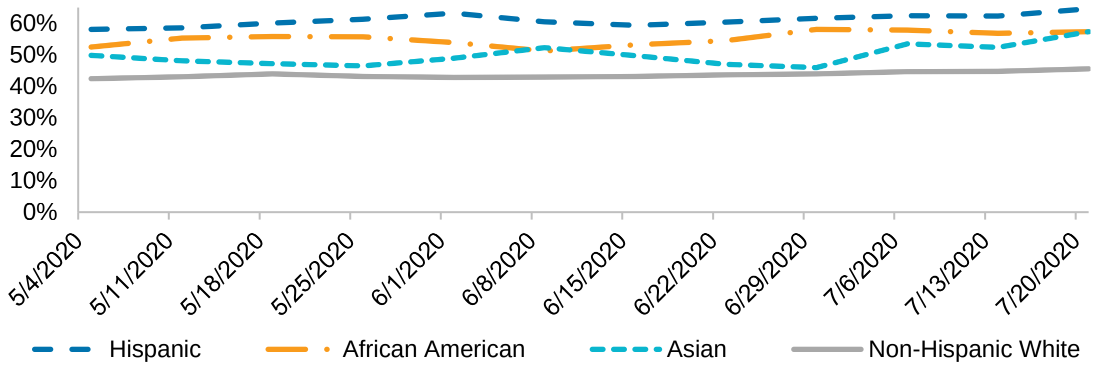
Source: Inside Mortgage Finance, 2020:23, June 5, 2020

The COVID-19 pandemic increases the potential that financial institutions face increased fair lending risk. First, to the extent that predictive performance of existing credit models falls, business justifications for variables included in the models may need to be re-examined, as the reasons used pre-COVID-19 might no longer be valid.

Second, different population groups, including those in protected classes for purposes of fair housing, have been affected differently. For example, minorities, particularly Hispanics and non-Hispanic African Americans, experienced larger actual and expected losses of income, relative to non-Hispanic whites, as summarized in Figure 5 and Figure 6.[13]

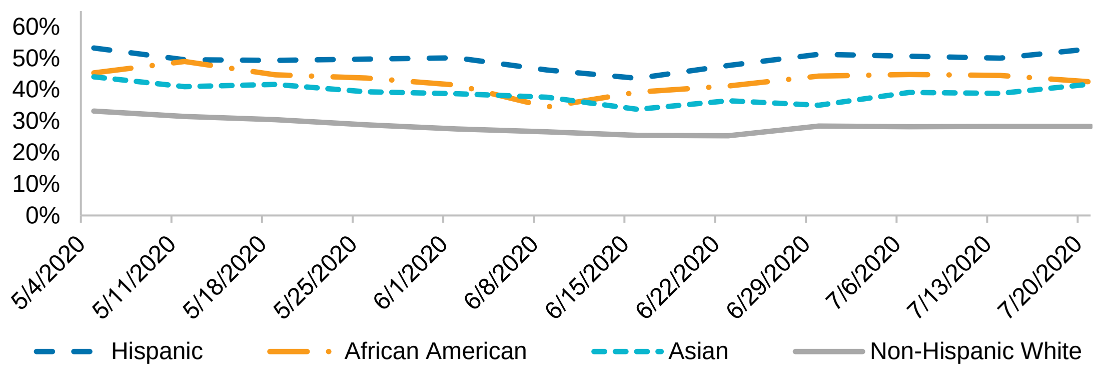
[13] Percentages are based on population 18 and older using U.S. Census Bureau Household Pulse Survey, available at https://www.census.gov/programs-surveys/household-pulse-survey.html, last accessed on August 18, 2020.

Figure 5: Experienced loss of employment income since March 13, 2020



Source: U.S. Census Bureau Household Pulse Survey

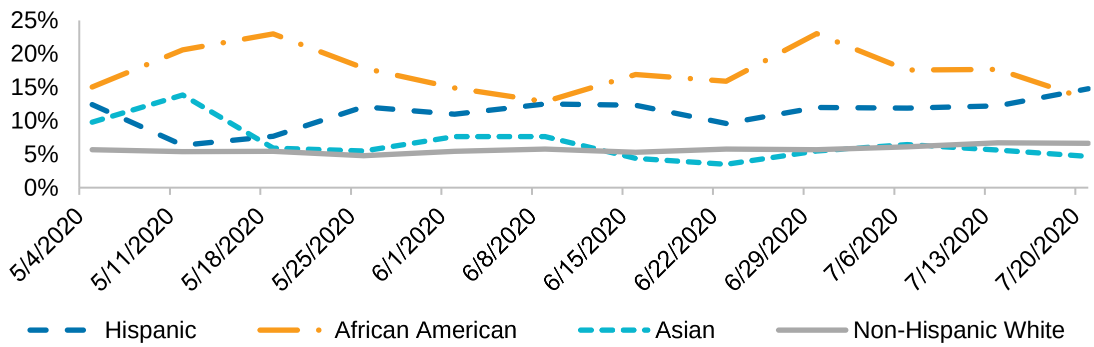
Figure 6: Expected a loss of employment income in next 4 weeks



Source: U.S. Census Bureau Household Pulse Survey

Minorities were also more likely than non-Hispanic whites to fail to make their mortgage payments and to have their mortgage payments deferred, as summarized in Figure 7 and Figure 8.[14]

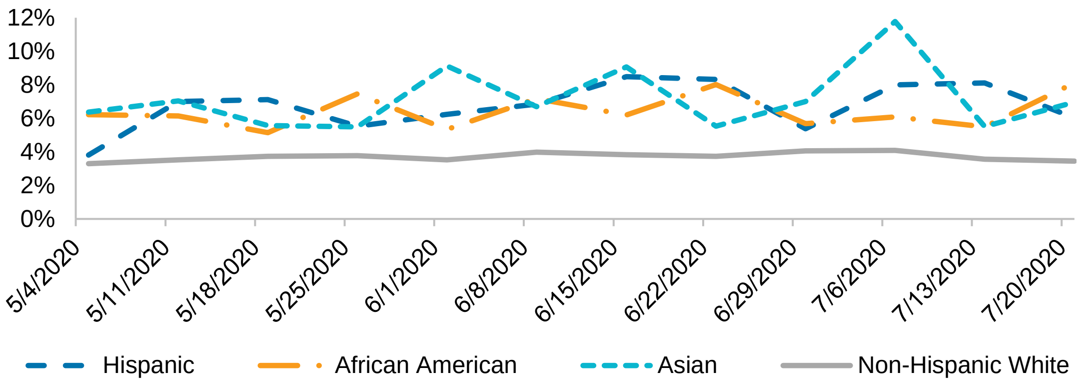
Figure 7: Did not pay last month's mortgage payment



Source: U.S. Census Bureau Household Pulse Survey

[14] These are for total population 18 and older in owner-occupied housing units. U.S. Census Bureau Household Pulse Survey, available at https://www.census.gov/programs-surveys/household-pulse-survey.html, last accessed on August 18, 2020.

Figure 8: Had last month's mortgage payment deferred



Source: U.S. Census Bureau Household Pulse Survey

Third, the demand for hardship relief increased rapidly and unexpectedly, and financial institutions had to respond in a relatively shorter time frame than would typically be taken to implement new or changed policies. Forbearance programs may have included manual and judgmental processes, which inherently increases fair lending risk.

Post-COVID-19 options for borrowers in forbearance

Fair lending compliance will also be necessary as forbearance periods end. For the loans held by Freddie Mac and Fannie Mae, several options will be available to borrowers. First, borrowers can choose full repayment, with a single payment made to satisfy all forbearance. This reinstates the loan at its previous terms. Second, borrowers might choose short-term repayment plans to catch up more gradually on payments missed during forbearance. They may also request full payment deferral, which would move the entire amount of the forbearance payments due to the end of the loan term as a balloon payment. Finally, they may choose to request a loan modification, which can change the terms of the original loan, including the interest rate, balance, and term.[15] Mortgage loan servicers should monitor all of the options offered and received for fair lending compliance.

Regulatory interest in fair lending and fair servicing seems to be on the rise, with enforcement activity expected from the Consumer Financial Protection Bureau. Of potential focus will be how financial institutions acted during the pandemic, including on servicers' compliance with the forbearance, foreclosure, and credit reporting requirements under the CARES Act.[16]

Mitigating fair lending risks

Financial institutions should consider the fair lending implications of the changed business environment, and their marketing and advertising, underwriting, or servicing policies. Facially neutral policies may present a fair lending risk if they result in differential outcomes by protected groups, such as race, ethnicity, gender, or age, identified in the Equal Credit Opportunity Act or the Fair Housing Act, if there are less discriminatory alternatives available, or if those policies do not have a sufficient business justification.

---

[15] This may be reflected with the same loan number and open date, with changed terms, or as a loan paid in full, and a refinance to a new loan number and new open date.

[16] Yemen Yang, "CFPB Enforcement Actions on the Rise, Warn Attorneys," *Inside Mortgage Finance*, Issue 2020:32 August 14, 2020, at 8–9.

Financial institutions should consider monitoring fair lending compliance with respect to the credit policies developed prior to the COVID-19 pandemic on a more frequent basis than what was previously deemed as sufficient, to ensure models are still predicting risk well across groups.

For new credit policies or changes implemented during the COVID-19 crisis, financial institutions should:

1. Document all updates to policies and procedures,
2. Evaluate whether the new policies/policy changes may have unintended differential outcomes across protected classes,
3. Document the decisions made based on the policy changes and any deviations from standard practice (exceptions),
4. Establish a timeline for reassessing the policy change, and
5. Communicate fair lending expectations to all appropriate staff.

About the Financial Economics Practice at CRA

Our consultants provide economic and financial analysis and advice to financial institutions, financial regulators, and counsel representing financial institutions. Our experts are skilled in quantitative modeling and econometrics, particularly as applied to issues in credit and compliance risk in consumer lending markets. We provide fair lending analyses of underwriting, pricing, and servicing practices for use in litigation and regulatory investigations. We also provide ongoing statistical monitoring of fair lending risk, including monitoring required under the terms of consent orders with federal government agencies.

Contact

Marsha Courchane
VP & Co-Practice Leader
+1-202-662-3804 direct
+1-301-332-2723 mobile
mcourchane@crai.com

Steli Stoianovici
Associate Principal
+1-202-662-3820 direct
pstoianovici@crai.com

CRA Charles River Associates

The conclusions set forth herein are based on independent research and publicly available material. The views expressed herein do not purport to reflect or represent the views of Charles River Associates or any of the organizations with which the authors are affiliated. The authors and Charles River Associates accept no duty of care or liability of any kind whatsoever to any party, and no responsibility for damages, if any, suffered by any party as a result of decisions made, or not made, or actions taken, or not taken, based on this paper. If you have questions or require further information regarding this issue of *CRA Insights*, please contact the contributors or editor at Charles River Associates. This material may be considered advertising. Detailed information about Charles River Associates, a trademark of CRA International, Inc., is available at www.crai.com.

Copyright 2020 Charles River Associates